

DRAFT

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

**Telecommunications Division
Market Structure Branch**

**RESOLUTION T-16775
October 30, 2003**

R E S O L U T I O N

**Resolution T-16775. Roseville Telephone Company (U-1015-C).
Order accepting subject to corrections or adjustments as a result of
future Commission Decisions, RTC's Annual Intrastate Earnings Advice
Letter Filing in Compliance with Decision 96-12-074.**

By Advice Letter No. 821 Filed on July 11, 2003.

Summary

This Resolution accepts Roseville Telephone Company's (RTC) intrastate shareable earnings advice letter filing, subject to any corrections, adjustments, or refunds that may be appropriate as a result of any future Commission decisions or actions. RTC shall implement sharing immediately, as it proposed, by applying a surcredit to applicable end-user charges that shall continue until the Sharable Earnings amount is reached.

Background

New Regulatory Framework (NRF)

Decision (D.) 96-12-074 established the New Regulatory Framework (NRF) for RTC similar to that originally adopted for Pacific Bell (now SBC California) and GTEC (now Verizon California) in D. 89-10-031. In D.89-10-031, the Commission replaced cost-of-service regulation for Pacific Bell and GTEC with incentive-based regulation known as New Regulatory Framework (NRF). NRF was originally centered around a price cap indexing mechanism, with sharing of excess earnings above a benchmark rate of return level. It is commonly known as a "price cap" model. The price cap model updates revenues yearly for inflation and expected productivity improvements for the telecommunications industry based on the formula:

$$R(t) = R(t-1) \times (1 + I-X) + \text{or} - Z$$

In this formula, $R(t)$ is the rate to be set for the current year, $R(t-1)$ is the rate in the prior year, I is inflation as measured by the gross national product price index (GNP-PI), X is productivity, and Z is other exogenous cost changes that are beyond the control of utility management and are subject to the Commission's review and approval.

Utilities under NRF are given an opportunity to earn a rate of return (ROR) above the traditional rate of return used to establish a reasonable profit level to be included in the price for utility services. The earnings sharing was adopted to provide a protection to ratepayers from an improperly functioning indexing mechanism. The sharing mechanism employs several ROR thresholds:

A market-based ROR (D. 96-12-074 adopted an overall market ROR for Roseville of 10.00%) that reflects what a reasonable market driven ROR would be for a similarly situated utility with comparable risk.

A benchmark ROR (150 basis points higher than the market-based ROR) that is higher than the traditional ROR to provide a strong incentive to the utility to operate more efficiently.

A cap (ceiling) ROR (500 basis points higher than the market-based ROR) to protect ratepayers against the indexing mechanism that results in unreasonably high prices that result in excessive profit for the utility.

A floor ROR (325 basis points below the market-based rate of return) to provide a protection for shareholders in the event that indexing mechanism results in unreasonably low prices that result in insufficient earnings levels for the utility that are reasonably close to the market based ROR.

RTC retains 100% of its earnings up to the benchmark ROR, shares with ratepayers 50% of its earnings between the benchmark and cap RORs, and refunds to ratepayers 100% of its earnings above the cap ROR. RTC was required to file an advice letter reporting its intrastate earnings for each year to determine whether sharable earnings exist. The filing is required to be made no later than April 1 of the following year.

RTC'S ANNUAL RATE OF RETURN FILING

Pursuant to D. 96-12-074, RTC initially filed its annual intrastate shareable earnings advice letter (AL) 781 on April 3, 2003, which is to be filed every April 1 for the purpose of reporting its actual ROR for the preceding year and whether shareable earnings exist. RTC reported its intrastate ROR for year 2002 to be 11.79%.

On July 17, RTC withdrew AL 781, and replaced it with AL 821 in which RTC restated its intrastate ROR for 2002 was 11.87%. Other references reported in RTC's filing included the following rates of return:

Market-Based	10.00%
Benchmark	11.50%
Ceiling	15.00%

RTC's benchmark ROR applicable to determination of 2002 shareable earnings is 11.5%. As a result of RTC's earnings exceeding the sharing benchmark by 0.37%, RTC reported that ratepayers would be receiving a total of \$482,516 refund which including 477,576 shareable earnings and \$4,940 cumulative interest on shareable earnings if sharing begins November 1, 2003. RTC proposes to apply a surcredit to applicable end-user charges for November 2003 and December 2003.

Notice/Protests

RTC stated that it mailed copies of AL 821 to interested parties. AL 821 was noticed in the Commission's Daily Calendar on July 28, 2003.

ORA filed a timely protest to RTC's AL 781. ORA first noted that it had insufficient time to comprehensively verify all the calculations. ORA also noted that the results of the Commission's evaluation of RTC's revenue requirement in I. 01-04-026 and any future commission audits of RTC could impact the RTC's year 2002 return. Additionally, ORA recommended that RTC should correct its AL 781 to properly include the interest for its 2002 shareable earnings calculation as directed in D. 01-06-077, Ordering Paragraph 4. Once RTC makes such correction, ORA indicated its belief that the Commission should accept RTC's AL 781 subject to restatement.

RTC timely responded to ORA's protest on its AL 781 stating that ORA had not identified any deficiencies with its AL. RTC acknowledged that it must include interest on shareable earnings as a component of the surcredit returning shareable earnings to ratepayers. On May 19, 2003, RTC filed supplemental information to include an adjustment for interest for its 2002 shareable earnings. RTC did not oppose the Commission's acceptance of AL 781 subject to any corrections or adjustments in I. 01-04-026 that may affect RTC's 2002 ROR. RTC, however, argued that the Commission should reject ORA's suggestion that RTC's earnings remain subject to adjustment based on any future audits.

As previously indicated, RTC withdrew AL 781 and replaced it with AL 821. RTC took this action to reflect the Job Creation and Worker Assistance Act of 2002, which contains

business tax benefits, signed into law by President Bush on March 9, 2002. One of tax benefits allows companies to take an additional 30 percent depreciation deduction (bonus depreciation) for qualified property purchased between September 11, 2001 and September 10, 2004, and placed in service before January 1, 2005. RTC later learned that some of its parent company's, SureWest Communications, bonus depreciation was not properly flowed through to RTC, and certain taxable differences between RTC and its parent company were misallocated. Roseville, thus, cancelled its AL 781 and filed the AL 821 to restate its intrastate ROR for year 2002 including adjustments for interest for its 2002 sharable earnings. No protest was filed on AL 821.

Discussion

RTC's 2002 intrastate earnings advice letter was filed in accordance with Ordering Paragraph (OP) 7 of D. 96-12-074. Both ORA and RTC agreed that interest for its 2002 sharable earnings should be included in RTC's 2002 ROR computation. RTC filed supplement information to include an adjustment for interest for its 2002 sharable earnings. Both ORA and RTC also agreed that results of I.01-040-26 may impact RTC's 2002 ROR. We believe results of future audit(s), if any, could possibly recommend adjustments to RTC's reported ROR. In order to preserve the Commission's options, we will accept AL821 subject to any corrections, adjustments, or refunds that may be appropriate as a result of any future Commission decision.

As it proposed, RTC shall implement sharing beginning with its next billing cycle by applying a surcredit to applicable end-user charges for November 2003 and December 2003 and that should continue until the Sharable Earnings amount is reached.

Findings

- 1) AL 821 was filed on July 16, 2003 to replace AL 781 filed on April 3, 2003. D. 96-12-074 required RTC to file advice letters by April 1 of each year.
- 2) Except the AL 781 was not filed on or before April 1, the AL was filed in accordance with D. 96-12-074.
- 3) In AL 821, RTC reported its ROR for year 2002 was 11.87%.
- 4) As a result of RTC's earnings exceeding the sharing benchmark by 0.37%, RTC reported that ratepayers should be receiving \$482,516 refund including \$477,576 shareable earnings and \$4,564 cumulative interest on sharable earnings if sharing begins November 1, 2003.
- 5) ORA filed a timely protest to AL 781.

- 6) RTC timely responded to ORA's protest.
- 7) Both ORA and RTC agreed that interest for its 2002 sharable earnings should be included in RTC's 2002 ROR calculation, and results of I. 01-04-026 may impact RTC's 2002 ROR.
- 8) ORA recommended and RTC did not oppose to the Commission's acceptance of AL subject to any correction or adjustment in I.01-04-026 that may affect Roseville's ROR for the year 2002.
- 9) No protest on AL 821 was received.
- 10) The reference RORs are as follows:
 - Market-Based: 10.00%
 - Benchmark: 11.50%
 - Ceiling: 15.00%

THEREFORE, IT IS ORDERED that:

1. RTC's Annual Intrastate Earnings advice letter reporting its rate of return for the year 2002 shall be accepted subject to any corrections or adjustments that may be appropriate as a result of any future Commission decision or order.
2. RTC shall implement sharing beginning with its next billing cycle by applying a surcredit to applicable end-user charges for November 2003, December 2003 and continue until the Sharable Earnings amount is reached
- 3.

This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on October 30, 2003. The following Commissioners approved it:

WILLIAM AHERN
Executive Director